Faculty Working Papers

THE COMING DEATH OF THE MIXED ECONOMY

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College of Commerce and Business Administration
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Summary

With the growth of instability and inflation in the 1970s, the heart of the economic system is exposed to strains, interruptions and overreactions that will make it impossible to continue to live on the present basis. Business and government policies aggravate cyclical instability. Economic power is increasingly concentrated, a trend assisted by conglomerate and multinational mergers. Prices are raised even in recessions, a retreat from market mechanisms that brings manufacturing closer to the regulated industries, in a variant of the transit syndrome. Fragmented government operations and policies facilitate the shifting of control from the public to the corporate sector. Government acceptance of responsibility for growth and welfare -- an impossible task -- makes it look inept and profligate, so that it becomes a focus for public anger. But the close connection between politics and economics prevents adjustment and restructuring to make institutions workable; it rules out integrated private and public planning of economic operations. The probability that the mixed economy can provide an alternative solution through pragmatic developments is hardly high enough to be believable.

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The Coming Death of the Mixed Economy

The mixed economy, that post-Keynesian sharing of responsibility for economic progress by government and business, is constantly becoming less viable. In the generation following World War II, it experienced its best years. The government's commitment in the Employment Act of 1946 "to promote maximum employment, production, and purchasing power" came at a time when wartime controls were being dismantled. The Act facilitated the development of federal programs designed to expand or support the economy while leaving the corporate sector free to accomplish its share of the tasks involved in achieving mutually desired goals. In the theory of the mixed economy, the corporate and the government sectors were thus regarded as partners basically working for the general good. The arrangement appeared to be satisfactory, and the mixed economy came to its maturity in the long postwar prosperity.

It is the departure from this state of affairs that is the source of concern here. With the growth of instability and inflation in the 1970s, the heart of the system is exposed to strains, interruptions, and overreactions that will make it impossible to live on the established basis. Stagflation is symptomatic. Attempts to find solutions in trade-offs and compromises are obsolete, and anything new that might replace them is strongly resisted.

In speaking of the death of the mixed economy, it should be understood that this in nc way implies the death of the economy, or even any major permanent collapse in economic activity. It does mean that the present roles and relationships are untenable, that the system needs restructuring to survive. In other words, there

has to be a change in institutions, under which private and public planning of economic operations will be integrated and results will be controlled.

The probability that such a change can be accomplished through piecemeal, pragmatic developments is hardly high enough to be believable. The possibility cannot be entirely ruled out, but the changes actually being worked for are diverse, back-stepping as well as forward-looking, and are distorted by interferences with scientific evaluation. The process of pragmatic selection, unplanned and controlled, is unlikely to ensure the survival of constructive gains. So outcomes are more or less accidental, the working out of undiscriminatory forces in an unstable, stagflationary situation.

Although the mixed economy is approaching its end, its demise will not happen overnight. The concentration of economic power, although it has progressed rapidly for a generation, is a slow process. Similarly, the process of alienation, although speeded by the Vietnam War and the following years of stagflation, needs further adverse developments before it reaches a pressure point that is explosive. On the other hand, such changes are not necessarily so distant that this generation can ignore them.

The Two Cycles

Current attitudes and policies reflect an unwillingness to believe that the economy is inherently and seriously unstable. Inflation is regarded as "the number one economic problem" and is often thought to be permanent. True, the inflation derives in part from long-term changes, but even more it is an outgrowth of the economic boom, which contains

large cyclical components. Such booms--and inflations too--have always ended in collapse and there is no reason to think results will be different in the future.

The way to understand the present position is to think in terms of two basic business cycles: the real cycle in production, investment, real income and consumption, and in the stocks of goods and facilities that are created by and used up in those processes; and the credit cycle which builds or runs off stocks of money and money substitutes by expansion and liquidation of debt. Both cycles are governed by similar stock-flow relationships and the link between them is the price system. The flows are amplified by the Keynesian multiplier, and the stocks govern the turning points.

The interplay of these cycles carries the economy to extremes that cannot be sustained: When one accelerates, it pulls the other along, and when the other in turn speeds up, it puts new life into the first. In the boom, as inflation is stimulated, there is increased willingness to hold stocks and to incur debt for this purpose, and high activity seems for a while to justify both, but only to the point of downturn, when the excesses are revealed.

At the peak of the boom, redundancy in stocks of all kinds tends to develop. This puts a damper on the advance and after the downturn, the excesses have to be liquidated. The way to reduce surplus real stocks is to cut back production and wait until consumption and disinvestment bring them down; but since these stocks are mostly very durable, it is a slow process, with unemployment remaining high (witness unemployment of over one-sixth of the labor force in 1939,

after the 1929 peak had again been recovered). The way to reduce the surplus money stocks is, in the first instance, to buy other assets, which drives up prices and depreciates money's value, and later to pay off or write off debt, and since writing off is speedier, it tends to dominate a major decline through spreading defaults and bankruptcies (again look at the 1930s).

Currently, the economy is beginning a recession that may eventuate in the depression of the 1980s. The expectation that business investment can hold up in the face of lower production and consumption is without foundation. Business inventories will have to be cut back with declining sales. Plant and equipment spending is also sensitive to the need for capacity, and the idea that investment has been deficient in recent years is mistaken. In real terms, business fixed investment was above 10 percent of real GNP (gross national product) in 1978-79. This is fully up to par for our economy, a full percentage point above the average for the peacetime years, 1955-64, though low for other countries. In manufacturing, investment has been adequate to keep capacity moving up steadily, and with production failing to grow, from the early 1979 high, it had already depressed the rate of utilization to the point that new investment commitments must fall. With the new setback, real fixed investment will join other declining components.

In the credit cycle, the position is even more clear cut. Money is created in credit transactions, mostly by the banking system on the basis of fractional reserves. During the boom, the expansion of credit has soared. In both 1978 and 1979, the total raised in US

credit markets was nearly $500 billion, with four-fifths going to nonfinancial sectors, and most of that to private borrowers. At this $500 billion annual rate, the increase in debt was more than twice the increase in GNP. It was three times the excess of private gross investment over capital consumption allowances. As the country floundered in the flood of credit, the volume of shaky debt that will have to be liquidated was magnified.

The Role of Government

These cyclical developments pose an insuperable problem of stabilization, solution of which is supposed to be the role of government. Considering them as characteristic developments in an economy growing with government help and thus ignoring their cyclical nature leads to the dual fallacy of thinking that the government has the power to control fluctuations and that the federal budget is responsible for the inflation.

Actually, the combined impact of the cyclical components is overriding. The situation may be analyzed in terms of real components of the gross national product--such as autos, housing, and business investment--or in monetary terms--such as money stock, credit, and private debt expansion or liquidation--the total swings reach magnitudes far beyond any potential adjustments in federal operations or budget that might be designed to compensate for them. Yet in the theory of the mixed economy the government is supposed to do so, and in the early 1960's it was argued that it had the capacity to do so. That argument has since lost its relevance, and instead there are various proposals, such as a balanced budget amendment, intended to reduce that capacity even further.

The complaints against the federal budget are not well founded. Inflation has not been primarily the result of government spending or deficits. Expenditures were pushed up in 1975 by the recession, but they have been rising more slowly than GNP since. Direct claims on resources through government purchases of goods and services have risen only about half as fast. During the last two years, the impact of the budget has been negative; from a large high employment deficit, it has swung over to a substantial high employment surplus, for a total deflationary swing of almost $50 billion.

Nor has government borrowing been the villain it is said to be. There is no reason to think that government use of credit is more inflationary than private use of credit, and except in 1975 and 1976, the government has not taken more than a sixth of the funds raised in US credit markets by nonfinancial borrowers. As inflation got worse, the federal share of the increments of debt fell from 25.4 percent in 1976 to 13.4 percent in 1978 and to less than 10 percent in 1979.

Despite these restraints, the boom got out of hand. A major complication grows out of the fact that government has become fair game for anybody who can profit at its expense. The politics of economics are mostly aimed at preventing the government from doing things in the public interest in order to provide benefits for specific groups. The pressures they create prevent the adoption of restrictive measures during the boom and make stimulative measures inefficient in the trough.

Tax policy is illustrative. Instead of letting the rise in government revenues eliminate the deficits, as the theory of the

automatic stabilizer would require, the politicians sought to gain voter support by cutting taxes--particularly to favor the inflators who were gaining the fastest increases in income. The results were not what was hoped because the gains obtained as tax relief appear as windfalls that add much less to real production than ordinary income would and add more to the bidding up of existing assets. No doubt the tax cuts actually made were supported by many good intentions, but leaving funds with those who already have good incomes is an inefficient means of achieving any real progress. Instead, one of its main effects is to translate private into government deficits.

Waste of federal resources is not necessarily inherent in the programs enacted; it often arises from private reactions similar to the reactions to changes in the tax laws, when thousands upon thousands of accountants, lawyers, and others quickly get busy figuring ways to minimize the payments that must be made. In the case of the federal commitment to full employment, a similar process of "adaption" has occurred. This development may be seen as a culmination of the trend toward absorption of government deficits into corporate surpluses. A 1975 study[1] of this trend revealed the following developments:

1. The disparity in fiscal results as between government and corporate accounts increased. Gross corporate savings rose with only minor setbacks from $25 billion in 1953 to $120 billion in 1975. Over the same period, the federal surplus or deficit held fairly steady near

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[1] V Lewis Bassie, "Fiscal Policy Without Controls" and "Cyclical Effects of Deficit Spending," Illinois Business Review, December 1975 and February 1976.

the zero line through 1969 and then plunged, to a deficit of $75 billion in 1975. The difference in results rose to an annual rate of about $170 billion.

2. The corporate advantage was mostly concentrated in recessions. In the 1954 recession there was hardly any difference; both accounts showed minor dips and recoveries. In both the 1958 and 1961 recessions, there were divergences in favor of gross corporate saving of about $10 billion. In 1970, this difference in results grew to more than $40 billion, and in 1975, to over $100 billion. The sum of these recession differences accounted for practically all of the $170 billion total over the entire period.

3. Differences in timing were also significant. In the first three recessions both accounts tended to move up and down together. In 1970 and 1975 gross corporate saving began to recover as soon as federal deficit increased and in 1975 ended the recession more than $10 billion higher than at the start. Thus, the process by which the deficits are absorbed into corporate surpluses has been greatly speeded.

Part of the trend in favor of the corporate sector had government assistance, through tax cuts and investment allowances, as did the support for other private savers. Even more, it derived from the price system, which acts as a transfer system to benefit those whose power to raise prices is unrestrained. No matter to whom the federal outlays are first paid, they go into spending and thus into the receipts and surpluses of the sellers. No significant amount, it may be inferred, is retained as savings by the unemployed or welfare recipients.

In boom times executives want government to "do its own job and leave them alone," but in bad times they want to be bailed out. Secretary of the Treasury, William Simon, reacted against the practices he observed as follows:

> When they are enjoying prosperous business, they rail against big government and growing bureaucracy; they talk of the need for more of the free enterprise that has provided this country the greatest standard of living in the world. That's fine. But when the business cycle turns down and their companies are hit in one way or another, then these same executives parade down to Washington to try to nationalize their losses. They want to keep their profits, but they want to nationalize their losses.[2]

Politics and Economics

The present situation has grown out of trends over long periods in which changes were constantly taking place. Among these, the increasingly close connection between politics and economics is of critical importance. Producers constantly try to advance their special interests through government processes. Washington is loaded with lobbyists seeking advantages for the organizations they represent. As one businessman described the situation, "Our life is closely interwoven with politics . . . Democracy is a rough game and we have to learn how to play it."[3] Playing it is not confined to corporations. The labor unions have their own strategy and tactics for influencing policy.

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[2] Chicago Tribune, February 12, 1976, p. 1.

[3] Quoted in L. Silk and D. Vogel, Ethics and Profits: The Crisis of Confidence in American Business, Simon and Schuster, p. 158.

The AMA works diligently to maintain gains of the medical profession. The American Farmers Movement demands 100 percent of parity at both taxpayer and consumer expense. However, the greatest resources and influence are at the command of the corporate sector.

The impact of lobbying is on the Congress and the politicans directing the administrative agencies. It is effective there, in blocking undesired legislation or getting other measures passed and in swaying regulators to favor the regulated at public expense. Still, there are limitations, because the politicians are supposed to represent the people, and the people are not convinced that the organizations doing the lobbying and the responses of government are giving them what they want. On the contrary, the pollsters have shown that over 80 percent of the people mistrust big business as well as government and consider better regulation necessary to the public interest. A retaliatory aspect of this popular view appears in legal cases that have gained inordinate jury awards from big corporations for damage or injury.

Big business tries to change these attitudes through public relations campaigns designed to redress "public ignorance." In taking its case to the people, the oil industry alone is spending some $100 million a year for advertisements, publications, program grants, and other means of influencing public opinion. This outpouring through TV and other media is designed to improve the industry image, telling the people about the good the corporations do and enlisting their support on particular issues. Other industries and their spokesmen have been playing the same game but no other on so large a scale. Although this

bombardment of public relations propoganda has some effects, the people have made judgments in their own way and have not greatly changed their opinions.

In Congress, the combined lobbying, political action, and public relations efforts are more effective, since these techniques are closely related to those by which the members were elected. Their effectiveness is demonstrated session by session, whether the subject is tax reform, energy policy, enforcing competition, or extending consumer protection. On the basis of extensive observation, Charles E. Lindblom, Professor of Political Science and Economics at Yale University concludes that big business has an effective "veto power" over major political decisions.[4]

In the long prosperity following World War II, the nature and concentration of the corporate sector has changed as it has become conglomerate and multinational. The magnitude and control of resources has soared through unprecedented opportunities for accumulation; procedures and policies have changed with steady downgrading of the influence of market forces; and the financial community, also multinational, has served as a selective integrating force. Concentration of wealth has its counterpart in the concentration of political power. With this, in the course of time, efforts originally aimed at making views known have merged into efforts to dominate government policy. Still the domination sought has limits; the corporate sector does not

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[4] Politics and Markets: The World's Political Economic Systems, NY, Basic Books, 1978.

want full authority, it does not want social responsibility, it wants power to rule out interferences with its own operations and entitlements.

Some legislation not desired by business does of course get through. The need to allocate the costs of social disutilities directly to the producers responsible for them has resulted in the environmental protection, health and safety controls that have been established. These are disliked not only because they are restrictive but because they add to costs and inflation. Complaints eagerly call attention to any bad decisions on the part of the regulators and charge them with extremes in applying regulatory standards. So a conflict situation develops: the bureaucrats must be put in their place, whatever the facts of their performance.

The idea that there is needless and useless staffing leads into the idea that government spending is too high and then it is just another step into the "campaign to cut big government down to size." Sometimes this is just a diversionary tactic but basically, it is an attempt to create pressures for the shifting of power from the government sector to the special interests who are promoting the campaign. The transfer of power obviously cannot be to individuals, to people who have little voice or choice, but to the corporate sector. At the extreme it becomes an attack on the mixed economy, a breaking of relationships that could lead to no constructive outcome.

The drive to bend the government to the will of the corporate sector derives from the nature of the corporation, from its basic

goal of maximizing the value of assets controlled.[5] (Note controlled, not necessarily owned.) Increasingly, it brings the productive wealth of the world into its domain, and at the same time it tries to conceal this fundamental concentration of control over economic life by presenting itself as just like any other individual. Its image building emphasizes this in such slogans as "men serving man" and "people producing for people." True, corporation executives, like other people, are mostly congenial seekers of the good life, but the essence of the corporation is not any mere collection of individuals. There is little the enlightened executive can do to change the system. Most do not try. The group dynamics of the management fratenity train him, reward him, discipline him, and replace him as necessary. Success and conformity become synonymous. What counts is the organization itself, the going concern that must be kept going, the organization that will live forever, accumulating in accordance with the patterns of thinking that will make it a "progressive" entity.

Unrestrained Pricing

The discretionary power to raise prices is an element in the inflation. It is a trend factor, or perhaps better said a continuing institutional change, making steady contributions year by year. So far has the control of prices by industry been solidified that it is no longer a question of whether prices will be controlled but only by whom and for whose benefit they will be controlled.

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[5] V Lewis Bassie, "The Goal of Business," Illinois Business Review, October, 1968, Bureau of Economic and Business Research, University of Illinois, Urbana, p. 2.

The use of corporate power aims at protecting the prerogatives to which business feels entitled. In this period of stagflation, the primary entitlement it is protecting, the one most subject to controversy, is the freedom to set prices at desired levels. Politicians generally bow to this idea, accepting it in confusion with personal liberty as part of the "American Way," though they may call for voluntary cooperation and resort to other jawboning activities when they feel inflation is putting them in a bad light with the electorate. They do not know, or at least are unwilling publicly to recognize, how widespread is noncompetitive pricing.

Monopolistic pricing has a long history. In this country, abuses recognized almost a century ago led to passage of antitrust laws at the turn of the century. These were watered down by the courts applying the so-called "rule of reason." This led by 1920 to still currently accepted principle of permitting free use of corporate power provided it was exercised with proper discretion--a judgmental conclusion always to be decided by the courts. Controversy again heated up in the Great Depression, when withholding production to keep prices high was aggravating unemployment. Increasing industrial concentration was at the heart of the issue.

The facts of concentration and its significance for behavior and public policy are spelled out in John Blair's book, Economic Concentration.[6] In introducing his discussion of the administered-price controversy, Blair states, " . . . the systematic analysis of

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[6]Harcourt Brace Jovanovich, 1972, 742 pp.

the relationship of industry structure to price behavior dates from the work of Gardiner C. Means in 1935 . . . "[7] In recent years it has been fashionable to avoid the term price administration; this avoids controversy because the tie to concentration and market power is usually ignored.

In the 1930s the well-organized oligopolistic industries were relatively few, and at the depression low, the mechanisms of price administration were in trouble even in those, but only as a temporary condition. Since then the practice of setting prices with little regard to the demand side of the market and adjusting production to make them stick has come to dominate the whole economy. In the 1970s, the oil companies and OPEC set a firm pattern by which public acceptance will be assured--create temporary shortages, make allocations, or just let shortages develop without planning remedies.

The changes in corporate structure and control and the displacement of market forces have not gone unnoticed by other scholars interested in the real world and particularly in the relationships between the private and government sectors. They appear, for example, in the works of John Kenneth Galbraith. His early work on countervailing power was in effect a justification of the mixed economy, in which the growing powers of any group would be matched and offset by others. Later, he saw the bureaucratic control group which he called the technostructure of the corporation taking command, and

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[7] Op. cit., p. 419. Keynes, writing his General Theory in those depression years, also stressed the importance of price and cost inflexibility.

now he sees a clear need for external restraints on prices and wages because competition is no longer effective. These modifications of his views by stages took place in adaption to the changing structure of the economy rather than as revisions of knowledge about a stable entity.

The control of prices under oligopoly depends on concerted action by several powerful corporations that not only set the prices but enforce them on the rest of the industry. For this few, the technique of control is variously described as conscious parallelism or tacit collusion; each knows in general how the others will respond and moves to keep in line. Price leadership is one of the most common ways this process works. The dominant concerns as a group confirm the initiative of the leader, within the usual pattern of minor differences. Thus, without any break of legality that would be provable in court, the whole industry arrives at a new monopolistic price schedule.

Enforcement also is tacit. It may not be fully effective but the position of any competitor can be attacked in various ways if the need arises. The small firms, although a large majority in number, handle only a small proportion of the business, and their profit maximizing behavior may permit small differentials, but if price cutting by any should threaten a large transfer of market share, the rest of the industry will react to prevent it, usually making the maverick unprofitable.

Concerted action and control require, of course, constant exchange of information. This may be accomplished in various ways--on golf courses, in clubs, at meetings of professional groups, and it also has

been established in what the Senate Subcommittee on Reports, Accounting, and Management called the network of interlocking directorships (April, 1978). The AFL-CIO points out that "Among the 130 top corporations there was a total of 530 direct and 12,193 indirect interlocks."[8] Direct interlocks among competitors are illegal, but 8 top oil companies show 44 indirect interlocks, where their directors meet as directors of a third corporation. The intercommunication of knowledge about what other big operators think and will do is not compatible with the maintenance of competition as demanded by free market theory.

The conglomerate merger movement has been influential in powering the monopolistic trend. These huge multi-industry holding companies are in a basic sense nonfunctional, since there are few management skills that apply everywhere. However, they do extend price administration and tax avoidance into new fields. Control of subsidiaries is decentralized, but the conglomerate insists that each should use business-like methods and produce satisfactory returns for the parent corporation. This usually means that prices must be administered properly and competition confined to the struggle for market shares. "Wasteful" cost increases are tolerable if they can be loaded into the prices charged. On the enforcement side, price cutting by competitors is discouraged because the resources of the whole conglomerate can be used to support the subsidiary if a price war should develop.

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[8] Markley Roberts, "The Interlock of Corporate Power," AFL-CIO American Federationist, August 1978, p. 6.

In the late stages of a great prosperity, many firms do not want to expand, and the cash flow they are realizing is beyond their requirements. Then conglomerate mergers and some multinational mergers develop logically from a corollary of the basic business goal: Control of assets can be expanded more rapidly by using excess cash flows to buy up existing companies than by undertaking uncertain and expensive expansion of enterprises already controlled. The resulting acceleration of the merger movement depresses real investment and slows the growth of the economy.

On occasion the price situation does get out of hand, so appeals are made for government assistance. The steel industry, for example, seems to prefer stagnation with high prices and low investment to meeting competition from abroad and calls for protection against imports. Labor, fearing loss of jobs, adds to the pressure. The world-wide economic growth that was aided for a quarter century by the pricing of international trade and investment is now being threatened by the revival of protectionism, not just in the US but all around the globe.

At home, there are many obstacles to entry in any industry dominated by giants. Full competitive opportunity comes only from access to capital, both real and financial; from control of markets, through sales organizations and advertising; and from the know-how of specialists supported by laboratory or other analytical equipment. The corporations that can handle all costs, many of which require heavy outlays of a character that is fixed, or at least largely detached from output, typically feel they cannot justify the various investments needed unless prices are not allowed to deteriorate. In practice, this means most of the changes must be upward.

Administered pricing in industry typically involves the addition of a desired percentage mark-up to average total costs at standard volume, including per-unit depreciation and other fixed or semi-fixed costs. Standard volume is a volume of sales expected to be realized year-by-year, averaging good with bad, over a sequence of time periods for which capacity is or is to be provided; it is a profitably high volume but still well within the limits of that capacity.

Inflation provides everyone who has the power to set prices with a release from restraints, a rationale to explain why customers must pay more. Costs are up, so prices should go up correspondingly. The upsurge in costs can then be made the basis for rising profits. Some effects of current pricing methods under these conditions were spelled out by informed observers of the business scene. One says, "businessmen have learned to survive and even thrive in the current inflationary environment." Two others agree that "Companies are passing on rises in materials and labor costs with alacrity and . . . profits will prove less vulnerable in the economic slowdown when it materializes." Thomas A. Murphy, Chairman of General Motors, adds that more frequent price boosts "enable us to make more adaptions to the realities as they unfold."[9]

For the economy as a whole, wages and salaries are the largest element of cost, and it has become customary to talk of wages as giving a cost-push to prices, and also of inflation as being a wage-price spiral. In actuality, wages are seldom the initiators of inflation or the prime determinants of how high prices will go. The unions do

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[9]"The U.S. Structures Itself to Live with Inflation," Business Week," Jan. 29, 1979.

bargain for favorable wage increases, of course, but their ability to gain desired boosts depends on the ability of management to raise prices enough to cover the increases. In this respect, labor and management are not necessarily competitors, as often depicted, but collaborators, because the increases are usually passed on, with profits correspondingly enlarged.

Given this economic accommodation between labor and management where unions are well established, one might think they have become teammates for gaining at the expense of the rest of the community. However, both wish to retain a respectable public image, and there are two reasons why their cooperation is far from complete. First, labor does not accept political domination by management; it backs candidates not to management liking and advocates programs of health, safety, welfare, environmental protection, consumer representation, and taxation that are costly and troublesome to management. Second, it is another corollary of the basic goal of business that accumulated capital should be used to the maximum, so there is a constant effort to displace labor with equipment in the drive toward more efficient methods of production. In other words, automation is not merely an outgrowth of technology but is part of the nature of capitalism. Thus, jobs are eliminated and the relative position of labor is weakened. In fact, labor has been unable to keep up with inflation in the 1970s and average real hourly earnings have fallen. The dominant role in inflation is that of the price setters, not the labor negotiators.

What is of greatest concern is that prices are now put up even in recessions. In the 1970s price administration proved fully adequate,

and the old economic theory which held that a downward shift in demand would lead to lower prices proved fallacious. Hence, declining prices no longer cushion a real decline; instead, rising prices as demand falls mean that real activity is cut still faster. True, some of the increases in 1973-75 were exogenous, especially in fuel and food, but the exogenous factors are not a complete explanation. The more general prevailing practice is what counts most.

The averaging of fixed costs on smaller volume tends to give prices an extra push in declines. It may be pointed out that prices are set on standard volume, not actual volume, so that this problem should be by-passed. However, producers under pressure do not operate on fixed principle and make adjustments considered desirable. Even if some do adhere to the principle, the averaging up of costs takes place in the process of deciding what constitutes standard volume, since ideas of what the market will take on the average tend to change as actual sales decline. Then, the very increases in prices reduce sales volume, against which the need for capacity is measured. So the downward revision of standard volume tends to be a kind of self-fulfilling prophecy.

To appreciate why this is of such great concern it is necessary to understand the transit syndrome. The transit syndrome is a disease of the local transit system, often fatal, that begins with a decline in demand as passengers shift to private autos. Since prices are controlled, attempts are made to sustain revenues by raising fares, and also to reduce costs by cutting services, thus idling equipment and workers. Higher fares and poorer service drive away more riders, further reducing revenues. Fares are still further increased, and

since capacity is excessive, investment dries up and equipment is undermaintained. The accumulation of downward tendencies creates losses despite inordinately high fares, and unless subsidies are provided, the enterprise fails.

In the broader economy, recession now tends to initiate a kind of generalization of the transit syndrome. It hits with varying impact on individual firms; the stronger firms in an industry may still profit while the weaker may be squeezed out as volume drops. In any case, with prices controlled and output restricted, the overall decline is reinforced. The basic stock-flow relationship of the real cycle reacts on investment at the start of the downturn and is reinforced as the price increases cut real demand and the reduction in volume boosts unemployment. The decline cumulates, and as the economy drops, the special contribution of unrestrained pricing reverses the old inverse relationship between price changes and unemployment. Instead of displaying a trade-off, the two move together. The result is a condition worse than stagflation, since it brings a situation in which a smaller economic pie is divided more unequally, in favor of the inflators. Failure of government to intervene is unthinkable, but the kind of government intervention we have known as part of the mixed economy does not solve the problem, it merely provides a series of stop-gaps.

The great institutional change in pricing from competition to administration cannot be corrected by pursuit of the existing powers and polices of government. It requires another institutional change, a compensating change in the body politic that may be equally far

reaching. Presumably one accomplishment of this change would put some limits on price raising. The typical cry of the "free market" advocates is that industry cannot survive without a profit. This is diversionary propoganda. Nobody contends that there should be no profit. The issue is quantitative, how large the profit should be. What it reduces to is whether a group of autonomous corporation executives has a right to set standards fo their own take and make enforcing decisions for pricing based on these standards without regard to how adversely the public's interest may be affected.

The corporation will survive. It has to be made to survive, because these productive enterprises are essential to the operation of the economy as a whole. What is not necessary is that they be responsible only to themselves, with their own interests and policies dominating the community as a whole.

The Propensity to Speculate

Another development that has been important in the inflation of the 1970s is the growth in the propensity to speculate with borrowed funds. This has spread from the financial community to the population at large, whose awareness of profit opportunities in speculative ventures is increasingly acute.

The great wave of stock market speculation on small margins in the 1920s did not penetrate much into the real economy and was killed in the collapse of 1929. Opportunities for any kind of resumption were limited in the 1930s and 1940s. However, awareness of potential opportunities grew in the long prosperity that followed World War II and came to infect much of personal spending and investing in the 1970s. The

period of disturbance, alienation, and uncertainty consequent on the Vietnam War opened the door to unlimited opportunities for profiting at other people's expense--and to a general feeling that such profiting was justified. The movement could hardly have reached the extreme experienced in the late 1970s without ample funding to feed the fires; it did receive such funding through government policies and the ingenuity of the financial community in utilizing resources to maximum advantage. What few understood was that the great credit boom which resulted was primarily cyclical in character.

On the personal side there was a veritable anti-thrift revolution. The philosphy of spend now, pay later, let the future take care of itself prevailed. Credit in many forms was made available to promote it, and terms were eased so that many auto contracts now extend over a 5-year term. Mortgages were used not just for homes but for many other things, including such "essentials" as vacation trips. In 1978 and 1979, the household sector drew upon credit for over $160 billion a year, almost 10 percent of personal income, and this became creator, via the multiplier, of an even larger proportion of that income.

The individual cannot be greatly blamed for trying to improve his situation through borrowing, but two difficulties are inherent in it: First, the fever displayed in this as in lotteries, casinos, and stocks of gambling corporations is itself a factor in instability, and second, a mass movement toward debt creation that opens the way for a mass movement toward debt liquidation is not good for the economy. The speculator is not interested in what is good or bad for the economy; he is not trying to build for the long future, merely to cash in quickly.

For its part, the financial community has participated in and encouraged the speculative boom. The drive for maximum lending and highest interest rates produces advertising to both attract savings and stimulate buying. "Buy now and save" is a standard merchandising motto. In housing, the exhortation becomes strident: "Sacrifice anything to get a toehold in the housing market!" A group of financial institutions advertises, "Want to pay $40,000 for a $35,000 house? Wait until next year!" The policy of "borrow to buy now because loans can be repaid later in cheaper dollars" is supported by easy credit. As one observer put it, "Credit has not only been made easy to get, it has been made hard to turn down." Only at the end of the upswing, after debt is over heavy, do lenders become cautious about bringing new applicants into the debtors' fold.

Tax provisions that in effect subsidize borrowing also encourage forward buying. The assumption of a heavy interest burden could be justified on the basis that the government would be paying a large part of it through income tax deductions. In fact, combining this with inflation made it possible to argue that there was hardly any burden or risk at all.

The mass media also contributes with ample publicity for offerings or enticements. The "facts" quickly go out to people via "news" that is printed, vocalized and pictorialized. Through all this consumers have been made sophisticated abut borrowing but not equally so about repaying. Many become overextended in multiple contracts. Some may then use credit to pay creditors. Others, cynical in default, are going bankrupt.

For speculation by the owners of wealth, new games are continually being devised. In the stock market, options trading affords a way around margin requirements; it has opened the range of issues on puts and calls and has soared in volume. Additions to and expansion of commodities futures has also continually set new records. Anyone can gamble in coins, art works, postage stamps, and horses. Financial futures, too, give new opportunities for trading--in interest rates, in exchange rates for major foreign currencies, and (it is proposed) in the movements of stock market index numbers. Only small margins are needed for futures trading. In addition, many kinds of tax shelters and get-rich-quick schemes, sometimes fraudulent, help to absorb some of the huge sums of loose money looking for magnification.

In banking and savings institutions, the changes have come fast, one on another, all through the 1970s, with the aid of the regulatory agencies. Interest payments and lower reserve requirements on time deposits led to constant shifting from demand deposits, and this enabled faster expansion of the total. The changes were helped along in various ways, with new instruments, new techniques of lending, and new secondary market operations. Standby credit and automatic savings transfers to cover overdrafts have also permitted larger transfers of funds to time deposit accounts. The regulatory agencies--not just the Fed but the comptroller and the deposit insurers--have been serving the special interests of the financial institutions under their jurisdiction, changing the rules to give each group what it wanted. The intention was to keep the institutions profitably healthy and free of

competitive disadvantages. Whether this was good for the economy, or for them in the long run, was beyond the immediate concern.

Through these changes the door was opened to an array of new forms of money, accelerating the expansion of the total stock. Checks or similar orders can now be written against various kinds of savings and time deposits, including credit unions and even money market mutual funds. Today credit cards may be more acceptable than cash; standby credit and automatic transfers prevent overdrafts; repurchase agreements give fast access to cash, as do certificates also, though with some penalties. Overnight Eurodollars are placed well up in the Fed's redefinition of the monetary aggregates. The confusion is such that nobody knows just what money is nowadays, and past relationships are obsolete.

The distinctions between one kind of deposit and others has become more and more blurred. With all deposits insured by government agencies, all seem equally secure. To make more and more of the total secure, the maximum deposit insured has been lifted in stages to $100,000--an assumption of a contingent liability that challenges the meaning of concepts like risk and security in the field of monetary affairs.

Economists have long called for restraining the growth of the money stock, but instead it accelerated. They spoke as if the Fed had the necessary powers, but it could not even keep many banks under its jurisdiction. New legislation, after the damage was done, has been enacted. The Depositary Institutions Deregulation Act (signed March 31, 1980) tries to strengthen the Fed's control and also frees banking operations for competition at higher interest rates. Thus Congress, like the

regulators, has created opportunities and benefits for lenders, but not for the people generally.

Banks and other financial corporations, like those in industry, pursue the same basic goal of accumulation, and this leads to similar outcomes of concentration and pricing behavior. Through holding companies, they become conglomerates and through branches and consortiums, multinationals, extending their sphere of operations and control. They exercise a great deal of allocative direction of real economic activity, but in the surge toward bigness they get into high risk investments, such as real estate trusts or loans to third world countries. The risks in some of the latter may not be revealed until a crisis develops. The unregulated Eurocurrency markets have soared to a total volume of $800 billion, of which about four-fifths is in dollars. At this level, Eurobanking represents another market not far from comparable in size with the U.S. market and is beyond the reach of national controls. Nobody knows what reserves or other guarantee of value underlies these loans. The market is very volatile and constantly adds to the threat that speculative movements of international hot money may move to whipsaw any of the world's banking system.

In the fluctuations of the economy, the demand for credit cannot be effectively stabilized. So interest rates vary widely, especially the short-term rates, because funds must be kept in earning assets, but the principles of administered pricing still have application. They operate mainly through a leadership phenomenon known as the prime rate, supposedly the rate charged the best of the bank's customers.

When the big banks confirm the rate set by the leaders most other banks conform to the pattern.

Changes in the prime rate are publicized the day they occur, so it represents a standard known to all, not unlike the old rule of "Pittsburgh Plus" that used to be relied on in steel. On this basis, Wall Street brokers charge their customers at rates up to 2 percentage points above the prime for margin loans on securities. Small banks outside the centers of finance also rely on this price indicator, informing their customers of loan rates in such terms as, "We have to charge the prime rate plus 3 percentage points for loans on receivables." In the instability of the 1970s, the prime took the lead from the volatile rates on treasury bills and commercial paper on the advances; then it was held high, lagging on the declines. Early in 1980 the prime surged to an unprecedented peak of 20 percent, in part because the authorities had given the word of approval and freed the banks from any official reaction, any jawboning even, from a government beguiled by claims of fighting inflation.

The banks take advantage of the official concern about inflation despite being among the chief builders of the inflation. What they are selling is credit, and the more credit they sell, the greater is the spur to inflation. Because inflation produces such disagreeable effects, people accept the high interest charges which are presumably aimed at bringing it under control. Partial justification for the rates is provided by the monetarist thesis that inflation should be controlled by tight money and that interest rates should be left free to go where the market takes them, without upper limit. Another kind

of justification derives from the specious theory of the "real rate of interest." This enables the lender to say of the highest interest rates charged since the 18th century that in real terms he is not making anything at all. It makes this claim possible by confusing income with unrealized changes in the purchasing power of capital.[10] Whatever weight they may put on these arguments, the main objective of the authorities is to slow the economy.

For the banks, it is a great advantage in having their own prices and incomes used by the authorities as a way of restraining the inflation of others' prices and incomes. But banks do not want restriction of their own volume of business, and their strong influence with the authorities results in giving them high rates without real tightening of money. Funds remained amply available to support whatever demand for credit could be enticed even at the peak of the boom in 1979-80. With a few incidental exceptions, that is the only kind of "tight money policy" we have had in this country. It is merely a "high interest rate policy." Inflation and interest rates build on each other and also build demands for credit, which then overbuilds the boom and magnifies the volume of shaky debt that will have to be liquidated after the downturn.

The new insitutional factors in finance--the speculative fever and the promotion of money substitutes--give new twists to the old patterns but have two main effects, both undesirable. They amplify

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[10] V Lewis Bassie, "The Real Rate of Interest: A Thesis in Pseudoscience," Quarterly Review of Economics and Business, Winter, 1976, p. 7-18.

the cycle by pushing the credit boom to an extreme, and they aggravate the inequality of wealth by concentrating savings and the gains from inflation in the hands of the speculators and owners of capital. The financial aspects of the cycle are out of control.

As long as the funds created by credit expansion remain active, being transferred from one user to another in real or speculative transactions, the boom is stimulated. As the boom runs its course they tend to pass into the hands of those willing to hold them inactive, whether for lack of profitable opportunities or pessimistic views of prospects. This happens when investment goals become saturated; it first slows the advance, then breaks the boom. The loose money looking for action begins to move into hoards, and after the turn, liquidation of debt through repayment or bankruptcy becomes the order of the day. The meaning of the cycle lies in the fact that there is no stability in any of its phases, most certainly not in the speculative blowing-up of the credit bubble at the peak of a stagnating economy.

Partners in Instability

Most of the current economic difficulties originate in the private sector, and the efforts to blame the government for them are inappropriate. Nevrtheless, changes in the structure and functioning of the economy require rethinking of the methods for dealing with inflation and unemployment, for in recent years government and business have in effect become partners in instability.

That something is wrong in the government is clearly perceived. However, the trouble is not with the budget or with the bureaucracy

as its doctrinare opponents believe. The failure of the government to avoid inflationary policies and to restrain such policies being pursued by producer and financial groups is political in nature. The idea that developments can be explained without reference to the political struggles that underlie them is an illusion still harbored by economists in disregard of the facts.

Many politicians have seen that recent expenditures and deficits have not been successful in providing the needed economic strength, but few are willing objectively to trace the failure back to its causes and take action to remove them. They are the policy makers, and the policies they make are a patchwork of confusion; each satisfies some group, but few satisfy a majority. Most believe they are in favor of measures to strengthen the economy. Some hope to do this by turning the clock back, by making industry competitive again, in complete disregard of the way anti-trust cases against such corporations as IBM, Kodak, and Kellogg remain bogged down for years in the courts. Others hope to improve the situation by deregulation where regulation already exists; these industries are often more favorable to continuing regulation than they are to introducing competition, because the regulation is frequently anti-competitive, and they reluctantly accept the change feeling that other means of price administration will have to be developed. In short, economic policy is like the federal deficit itself. It has no independent existence but merely appears as the working out of a myriad of specific policies in combination with new developments in the economy.

After any recession, the government properly maintains fiscal and monetary stimuli for a while because business fixed investment lags and does not make a strong recovery until industrial protection has recovered all the way to the past peak. Presumably, government should begin to cut back when that point is reached. However, high unemployment may persist beyond that peak, especially if the measures relied on are better designed to expand liquidity than to increase the number of jobs available and the hoped-for stimuli are aborted. Then deficits continue, money is generated and cumulates year by year, and the cumulative total becomes a basis for inflation. This is not the main "engine of inflation" because private debt expansion is much greater, but it is not good that the government should be contributing at all to overheating the economy in boom times.

Action on the revenue side is important in this, as already indicated. In fact, tax cutting has become almost the sole means relied on for stimulating the economy; it is appropriate only in the very short run, when quick action is needed, and beyond that it is very inefficient and involves the greatest waste of government resources. Plans for positive action which would directly deal with the unemployment and related problems in an extended recession are almost completely lacking. Deficits without postive effect therefore appear; and the enemies of government who are the main beneficiaries have aother complaint to publicize.

A widely voiced opinion holds that federal deficits are different because the Fed has to finance them through monetary expansion. Actually, the Fed accommodates both Treasury and private credit demands in fostering

recovery and growth. If anything, it is more responsive to the demands of the financial community than those of the government. This means monetary expansion, which continues as the recovery progresses, and as it cumulates to the point of excess liquidity, it spurs inflation. Interest rates are then put up to restrain the advance, but they tend for a while to be more inflationary than restraining: They immediately boost costs of working capital; the announcement effects are positive for business decisions; the expectation of higher capital costs in the future creates a desire for increased cash flow immediately; and all these can be made effective quickly in prices. Thus, the tax cutting and monetary policies used in promoting the recovery remove the limits on the upswing. Expansionary policies carried too far, partly for political subservience rather than compelling economic reasons, push the ceiling on monetary-spending activity to so high a level that either a reversal must ensue or inflationary pressure will mount to explosive force.

Only in the late stages of the boom when speculation becomes rampant, does the Fed react strongly. In 1929 the concern was with the soaring stock market. In 1979 with wider speculation the Fed again became panicky enough to disregard the dangers of policy that would break the boom.

With inflation accelerating and the outcry against it becoming strident just a year before the election of 1980, the Administration too found it intolerable to wait for the boom to run its course. It not only backed the Fed's action but called for complete balancing of the 1981 federal budget. The proposed cutting of expenditures

added a little to the deflationary impact had already been achieved by fiscal policy, and it will further depress the real cycle. The result is to aggravate the underutilization of capacity, so that capital spending will join other key components on the decline. Making policy changes a phase of cyclical behavior in this way coordinates the thrust of both partners in the mixed economy toward maximizing the depth and the duration of the recession of 1980.

After the downturn, fiscal and monetary policy will be reversed but only too late. The negative forces released by the interaction of real and financial cycles are then overriding. Rapidly mounting federal deficits and antagonism to spending that has "failed" make fiscal policy impotent, and monetary policy goes back to pushing on the proverbial string. In other words, any move that turns the cycle down changes many things in the private economy and cannot by its reversal have an equally powerful effect in turning the economy back up; the new positions reached will not be consistent with expansion under the new "encouraging policies."

The basic real investment cycles, once turned down, tend to run to extremes. As the Keynesian model showed, there is no floor for fixed investment much above zero, so the higher the rate of output and stockbuilding achieved in the boom, the greater the contraction that follows. In 1979 gross private investment rose to a rate of almost $400 billion and consumer durables to over $200 billion. The stockflow relationships governing investment not only assure sharp declines but a long drawn-out period before growth can be resumed.[11] Furthermore,

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[11] See V Lewis Bassie, Economic Forecasting, McGraw-Hill, 1958, esp. Chapter 10.

the transit syndrome will cut the underlying consumer demand which provides the criterion for distinguishing between desired and excess stocks. Thus, in a concerted decline, the potentials for depression of investment in plant and equipment, housing, and inventories are relatively much the same as those of the late 1920s.

Similarly, the credit cycle that has created the excessive money supply and the huge overhang of debt is headed into a downturn. In the credit cycle, expansion typically swings all the way over to liquidation in a major decline, and in 1979 funds being raised by private borrowers reached a rate of $350 billion. Liquidation on even a moderate scale could hardly be orderly. Speculators who change course are never willingly patient, and the public's attitudes have changed in ways that make maintenance of the integrity of debt dubious. Foreigners, many of whom have even less respect for the obligatory claims of debt, are being put under unbearable pressure by oil and food prices, by soaring debt service, and by efforts to strengthen the dollar. So in a deep recession, the whole debt structure will fall apart. The chain reaction of financial liabilities will produce a tidal wave of defaults and bankruptcies. The dumping of assets repossessed or foreclosed will aggravate the transit syndrome by reducing the volume of new production that can be sold at fixed prices. The depth of ruin cannot be conceived by those who think that future recessions can be no worse than 1974-75. In short, the private economy pulls the stops on the downslide, and again the potentials are not significantly less adverse than in 1929.

What this picture of partners in instability conveys is the fragility of the mixed economy. The drive of market forces, the drive for

capital accumulation, can no longer produce the equilibrium solutions conceived by economic theory and sought by administrators everywhere. As Albert Sommers puts it, "The outcomes produced by the free market, and the outcomes foregone by the free market, do not necessarily add up to a liveable, survivable world by modern standards, much less the best of all possible worlds."[12] In turn, the government cannot live up to its commitment for full employment. The policy instruments available to it are not big enough.

The Rejection of Planned Solutions

As typical developments revealed in past experience, both extreme inflation and severe depression eventuate in breakdowns. When conditions no longer promise prosperity government and business go separate ways. Government must still try to minimize hardship and promote recovery, but business is not accountable for its share of the decisions affecting the state of the economy. Business must seek its own salvation in what it regards as protective action. So instead of helping government achieve an early stabilization, these self-seeking responses hamper government efforts.

With the displacement of competition in market pricing, an alternative form of economic governance must be developed. The most obvious source of such an alternative would seem to be some form of government-led planning.[13] Properly considered, planning is a method of problem

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[12]"Ends and Means in the 1980s," Across the Board, Sept. 1979, The Conference Board, NY, p. 23.

[13]Gunnar Myrdahl, Beyond the Welfare State.

solving that anticipates developments, sets goals in the light of those developments, puts resources to work for reaching those goals, and utilizes controls to ensure that operations are carried through as efficiently as possible. Note that planning and controls are coordinate terms: without controls, planning is futile, little more than a description of one course rather than another; without planning, control is tyranical and meaningless, a source of endless controversy.

Neither the planning nor the controls need to be dictatorial and inflexible. In fact, in a situation where extremes of discomfort are reached, planning may be the best way of avoiding authoritarianism; for if plans cannot be carried out cooperatively and effectively, dictation may be forced, with an end to capitalism or democracy, or both. But it cannot be carried out that way if politicians and businessmen insist on maintaining the existing shares of power and influence in the economic sphere.

Many businessmen utilize planning in their own operations, as part of the means to their success. But they thoroughly oppose it on a broader scale, as if the success of the general economy was not relevant to their own. The kind of planning they do for themselves has neither the focus nor the absence of destabilizing effects that would make it suitable for dealing with overall economic problems. Yet they insist on an ideology of laissez-faire, a refusal to give up any sovereignty. Costly regulations have been forced upon them, and they properly complain when the regulation is excessive and inconsistent; what they may not see is that it has these undesirable characteristics because it was passed piecemeal, without being considered in the light of all its

effects. So they resist in a way that is more likely to bring on what they fear than to give them the relief they want. In totality, their complaints, some valid, some merely self-seeking, become part of the confrontation that prevents cooperative solutions.

In the U.S., we have some planning in government also. Budget making is a form of planning for federal expenditures and revenues in the year ahead. It shows greater rationality and promise since the implementation of the Budget Control Act of 1974. However, the budgetary process needs to look further into the future and to be broadened to other kinds of economic and social problems. Better coordination of fiscal and monetry policy is also desirable.

Hardly anything can be done right in legislation or regulation without planning. Hardly anything can be done right in stabilizing the economy without controls. Many things cannot be done at all unless done by government; there is simply no way the market could pay entrepreneurs to undertake them. The Europeans are far ahead of us in recognizing these facts and are far more willing to face them without quibbling about words. In this country, the structure of our political institutions, and the processes of selecting candidates for election to key posts, seem designed to prevent the more fundamental solutions from even being talked about.

Many proposals for making the government and the economy work as they should have been and are being made. Common Cause states that it "is fighting to change our government without destroying it . . . before it destroys itself," and to that end proposes numerous "radical--but reasoned--changes." In her recent book, Barbara Ward points to ways

for solving a multitude of currently critical problems, problems encountered by advanced and developing nations, by cities, and by people in their social and material environments.[14] Bringing them all together in a single volume averts most of the conflicts and partial viewpoints appearing in the specialized works of others. However, the very myriad of good ideas, not just in her book but in similar proposals, results in less acceptance than their authors deserve. The confusions and cacophonies produced as each proposal is criticized, often by well-heeled manipulators of the public attention, reduce them to whispers in the arena of legislative action.

Thus, the need for essential controls is ignored. More than a generation ago it was recognized that stabilization cannot be effective without some control of real investment. If everybody is free to do anything when he wants to do it, and to do nothing at other times, the concert of opinion will produce large fluctuations. Nobody has wanted to tackle this complex problem. Nobody really could do anything about it in the absence of knowing how increasing or lowering investment would fit with other variables, of deciding how the timing of acceleration or braking could be arranged in a phase of the business cycle where it could be both effective and tolerable. Nobody ever will unless it is seen as part of the moving pattern of economic development as a whole, that is, in its role as a basic element in a general plan.

More current in the realm of controls is the sorry record on money and credit. Economists have complained for years about the failure to

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[14] Progress for a Small Planet, Norton, 1979.

restrict the money stock, and their valid pleading on this point long went unheeded. However, as the recent experience shows, were money to be made really tight while interest rates were free to rise without limits, the potential for transfers from borrowers, the active agents of economic expanision, to lenders, the passive profiters from money holdings, would soar beyond any reasonable justification. Both monetary expansion and interest rates should be matched to the requirements of a general plan.

Most important of all in the present situation are price and wage controls, since the private controls already in place are not likely to be acceptable in the long run. Leaving prices free not only oppresses the weak and poor, it destabilizes the economy, diverts investment into nonproductive channels, drains the force from government efforts to promote prosperity, allows taxes to be passed on to consumers, and creates a power base for the domination of political action. Yet the cost of control is said to be too high.

Denial of this is not to say that prices have to be held entirely stable. Various degrees of flexibility are possible, but if controls are to work, they must be mandatory and they must be applied with determination. In 1972, the last period when controls applied, there was largely voluntary cooperation through the election year. Then, compliance was made voluntary by President Nixon, much to the confusion and embarrassment of his controllers, and the ineffective operation of the program led them to say that control is impossible. In contrast, people do not accept that conclusion. The large majority favors controls, and even the unions favor mandatory controls over "guidelines" that are effective mainly in restraining wage increases.

The controversy cannot be resolved in its own terms. Price controls by themselves would suffer unalterable opposition and many difficulties in setting standards and in enforcement. A strong case can be made that they could only be made workable as part of a more general system of planning. Note that that was the situation during World War II.

Economists argue against controls mainly from their preoccupation with outdated notions about the allocative functions of free market prices, which are supposed to direct resources into their best uses. Instead, obstacles to efficient allocation by the present day market are insuperable. The system of competitive pricing--however nostalgically we look upon it--has been replaced by an inefficient system of pricing governed by the private politics of non-price competition and the hunger for wealth. Pricing focussed on accumulation in a financial sense, on controlling prices high and output low, reduces the need for capacity and so lowers investment and the accumulation of real capital needed for increasing productivity. Even when monopolistic pricing applies only partially, the theoretical solutions break down, as was shown in the theory of "the second best." Prominant economists like J. R. Hicks and Joan Robinson have concluded that competitive equilibrium theory no longer retains whatever validity it once had.

The oil industry has been very revealing. Its part in the inflation is brushed off as the result of a foreign conspiracy. But note that the big oil companies are not ours; they are not national but supernational organizations and deal with governments everywhere on the basis of their own powers of negotiation. Note also how eager domestic producers have been to grab all the benefits of OPEC's

"artificial pricing," how quickly they spread the inflation to alternative sources of energy, how they lobbied for decontrol, how they created dummy transactors, how they welcomed the opportunity to share the benefits of conspiracy in the name of freedom. The principles underlying this behavior are not confined to the oil industry. Control would indeed interfere with allocating them into the hands of the inflators.

So the public interest demands price controls as well as planned direction. But prices cannot be controlled in a system where the beneficiaries of setting them as high as they want have the upper hand. Controls over prices exist--through mutual understandings, through conglomerate mergers, through multi-national extensions, and through batteries of legal talent that are expensive but pay for themselves many times over while delaying and preventing adverse court decisions. The right to set prices is the corporations' crucial entitlement. They will stonewall to keep it. And they now have enough influence over the politicians and the agencies to secure the status quo.

So inflation will persist, with some moderation from sacrifice sales and dumping of excess stocks, until the mechanisms of price administration break down. That happened at the lows of the depression in 1932-33. Now the mechanisms are much stronger. They would break only at such an intolerably low level that the whole structure of the politico-economic system would be shaken. The fate of the nation is written in the shibboleths of "free private enterprise."

No doubt there is good reason to fear authoritarianism. That it can reach dreadful extremes is amply demonstrated in the history of the last half century. What may be the biggest current mistake is thinking

it can be avoided by setting up a confrontation of ideologies that will be resolved by public-relations methods involving control of the mass media. Ultimately, the issue must be resolved in the facts of progress, welfare, and equity. A decade of stagflation is already calling in question claims of the superiority of the existing "mixed" system. Systematic rejection of all the means to new solutions is nevertheless the order of the day. Proposed changes that could help solve emerging problems without serious disruption but with some departure from tradition are rejected as consistently, but with more vigor and excitement, than before. This amounts to staking everything on success in turning the overall economic trend upward quickly. As Irving Kristol points out, it is " . . . only so long as economic growth remains a credible reality that democracy will remain an actuality."[15]

At the heart of the mixed economy's fatal illness is the instability of the economy. A series of recessions growing in amplitude and merging into the depression of the 1980s will boost unemployment into double-digit figures, perhaps multiply it two or three times, and produce violent reactions. Inflation and recession will then be mutually supporting, and this combination represents the extremity of hard times for the people.

Currently the prospect is not like 1933, which was a crisis of deflation, not slumpflation, and the people's faith in the powers and good intentions of the government never faltered. The chaos of

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[15] Wall Street Journal, November 26, 1979, p. 24.

depression with inflation will surely tear up democracy as we have known it. As the result of the one-two punch of inflation followed by depression Hitler came to power in Germany. One of the important lessons of Nazi Germany is that the shifting of powers may downgrade any of the pre-existing classes. Unless transfers of control in this country can be designed rationally, they will produce haphazard and indeterminate results. For such changes to have a rational design, the objectives of the corporate sector would have to change; power that is not accountable will not be acceptable in the long run. That such a change is possible, and that it could be enforced even if seen and agreed to by corporate leaders is doubtful. On the political side, the prospects for any significant move toward a solution look dim; the American party system as now constituted is incapable of developing new alternatives.

Distrust of the government is now on a par with distrust of big business. In the mixed economy, the two temporarily combined to form an establishment relied upon for prosperity, social order, and equity, and both are being charged with responsiblity for its failures. Up to this point, the people's cynicism and anger have focused more directly on government, which is presumably committed to their welfare, and frustration so far leads mainly to negative voting and non-voting. The people know they do not control and feel cannot displace, the corporation executives, but they are not unaware that money and media politics interfere with adjustments in their favor. So increasingly their anger finds a strong focus on industry, too.

The exact nature of possible outcomes cannot be defined. One possibility is that the drift toward dominance by the corporate elite will continue and even be accelerated in adversity by the politicians' desire to "restore business confidence." Then, government programs and policies, basically subservient to the dictates of the potent minority, would put greater emphasis on progress for business, and the supporting political party greater emphasis on law and order. As an alternative, the combination of economic instability and public frustration might at some point produce a new political party and a government basically detached from the corporate sector as now constituted. In that case a basic reformation of the corporation laws would probably be undertaken to make top corporate personnel accountable and removable as well as to make corporations more explicitly public institutions with a share of responsibility for the public interest in both good times and bad. In either case, the change would be presented as a response to popular demands, and the semblance of democratic forms would be preserved, however much they might be subordinated to authoritarian leadership. In either case, also, the mixed economy would be dead.

V Lewis Bassie
University of Illinois
December, 1979

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